

NOT-FOR-PROFIT LEGAL ALERT

NONPROFIT GOVERNANCE:

NONPROFIT NEW YEAR'S RESOLUTIONS

January 2017



With The Non-Profit Revitalization Act of 2013 (the “Revitalization Act”) having become effective on July 1, 2014, the law governing New York nonprofits saw its most dramatic change in 40 years. There were a number of amendments of the provisions of the Revitalization Act over the course of 2014, 2015 and 2016, with a significant series of amendments having been signed into law on November 28, 2016. Nonprofit governance, oversight and accountability are very much in the spotlight as we enter 2017. Below are six **Governance New Year's Resolutions** for you to consider.

➤ **MINUTES, MINUTES, MINUTES**

Contemporaneous documentation of Board and Board committee meetings and actions is part of each director's fiduciary duty to the organization. When our firm is consulted by persons seeking to bring claims against a Board or Board members, one of the first things that we ask to see are the Board and committee minutes. **What is or is not in the minutes can be the cornerstone of evidentiary material to support breach of duty claims against directors and officers.** As a result, **minutes should be viewed as anything but a routine and insignificant exercise.** Here are a few things to keep in mind about minutes:

- ✓ Minutes should be contemporaneously compiled and circulated, and wherever possible, should be approved at the next Board or committee meeting. Minutes should not be considered final or inserted into the corporate minute book until they have been formally approved.
- ✓ It is possible for minutes to say too little or too much. Erring in either direction can provide a source of potential liability for the organization and for individual directors and officers. It is therefore prudent to compile minutes in consultation with the organization's legal counsel.
- ✓ The Revitalization Act, which went into effect on July 1, 2014, contains enhanced governance and oversight requirements that must be reflected in the minutes of meetings, for instance:
 - ❖ the minutes must reflect compliance with the new audit oversight requirements and procedures;

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- ❖ the minutes must reflect the requirement that only independent directors (as defined by the Revitalization Act) may participate in board or committee deliberations or voting relating to certain matters;
- ❖ the minutes must reflect compliance with the demanding and complex new provisions governing potential conflicts of interest and related party transactions (including who is present when these matters are being deliberated and decided, and in certain circumstances, both heightened voting thresholds for approval and a requirement to consider alternative transactions).

➤ **NEVER LOSE SIGHT OF YOUR CORPORATE PURPOSES**

The Certificate of Incorporation was likely the first document your organization prepared. Many organizations lose track of this fundamental document or ignore its provisions. They do so at their great peril. Your organization's Certificate of Incorporation contains a statement of your organization's corporate purposes. **Any activities outside of the purposes stated in your Certificate of Incorporation are not permissible, and would constitute a breach of fiduciary duty on the part of the members of the Board of Directors.** If you wish to conduct activities outside of the scope of the purposes stated in your Certificate of Incorporation (including expanding your purposes to accommodate new activities not originally contemplated), the Certificate of Incorporation can be amended to change the organization's purposes. Such an amendment by a charitable corporation requires obtaining the approval of the New York State Attorney General. An amendment of corporate purposes may also require notice to, or consent of, state regulatory agencies.

➤ **UNDERTAKE A GOVERNANCE AUDIT TO ASSURE COMPLIANCE WITH LEGAL REQUIREMENTS**

Nonprofits should, as a matter of good governance, undertake periodic governance audits to assess their governance practices from the dual perspectives of compliance with the organization's existing governance documents and current legal requirements. A governance audit can be fast and easy when conducted by experienced counsel, and is an important step towards fulfilling each director's fiduciary duty. **The beginning of a new year provides an opportune time for nonprofits to undertake a governance audit and make the adjustments necessary for good governance and compliance with legal requirements (including the new governance requirements of the Revitalization Act) – although any time is a good time for a governance audit.** Among the items a governance audit should examine are:

- ✓ Compliance with the demanding and complex requirements and procedures of the Revitalization Act regarding conflicts of interest and related party transactions.
- ✓ Bylaw and committee charter amendments to assure compliance with the new requirements of the Revitalization Act and best practices.
- ✓ Assessment of the activities of the organization in light of the purposes of the organization stated in its Certificate of Incorporation. Activities must always be

measured against purposes, and any activities outside of the purposes stated in your Certificate of Incorporation are not permissible, as explained above.

- ✓ Whether governance documents and requirements are being properly implemented. Organizations often have governance documents that comply with legal requirements, but the organization falls short when it comes to implementing the demanding requirements of these documents. Such failures constitute a breach of fiduciary duty by the members of the Board of Directors.

➤ **REMEMBER THAT COMPLIANCE WITH THE REVITALIZATION ACT PROVISIONS REGARDING CONFLICTS OF INTEREST AND RELATED PARTY TRANSACTIONS IS AN ONGOING DUTY AND REQUIRES ONGOING ACTIONS**

The conflict of interest and related party transaction provisions **require continuing vigilance and attention**. First, your nonprofit must have a conflict of interest policy that complies with the extensive mandatory provisions of the Revitalization Act. But you cannot rest there! Conflicts and related party transactions must be disclosed in writing as they arise. They must then be analyzed and handled pursuant to the explicit requirements of the Revitalization Act and your Policy. **Compliance with these requirements must be carefully documented in the meeting minutes, as noted above.** In addition, directors are not only required to submit a conflict of interest disclosure statement annually, but also *prior* to each director's *initial* election to the Board. It should also be noted that many existing conflict of interest policies (including the IRS Sample Conflict of Interest Policy, which is used by many nonprofits) are not compliant with the heightened requirements and procedures contained in the Revitalization Act.

➤ **BE AWARE THAT CERTAIN BOARD FUNCTIONS ARE LIMITED EXCLUSIVELY TO INDEPENDENT DIRECTORS**

Only "Independent Directors," as defined in the Revitalization Act, may participate in any Board of Directors or committee deliberations or voting on matters subject to the Revitalization Act provisions on conflicts of interest, related party transactions, audit oversight and whistleblower policies. The definition of an "Independent Director" under the Revitalization Act is quite complex and demanding, and its application results in many directors being determined to not be independent. Nonprofits need to consult their legal counsel to determine which directors are independent under these rigid standards. Many nonprofits may need to take steps to recruit additional independent directors. The provisions with respect to Independent Directors were revised as part of the November 2016 amendments to the Revitalization Act provisions. Governance documents, practices and procedures must be analyzed and revised in light of these most recent statutory changes which are effective on May 27, 2017.

➤ **REMEMBER THAT EACH BOARD MEMBER HAS A LEGAL DUTY TO ENSURE THAT THE ORGANIZATION COMPLIES WITH ALL APPLICABLE LAWS AND REGULATIONS**

One of the three fundamental fiduciary duties of a director under New York State law is the duty of obedience, which includes the duty to ensure that the organization complies with all

applicable laws and regulations. Failure to fulfill legal obligations can have tremendously adverse consequences, including the possible invalidity or voidability of corporate actions and authorizations, and judicial proceedings brought by the Attorney General (who has expanded enforcement powers under the provisions of the Revitalization Act). Breach of duty allegations often provide the basis for claims against a director from within the organization. Governance failures in this area can be catastrophic for the organization and constitute a breach of fiduciary duty that can result in personal liability for members of the Board of Directors.

The Revitalization Act has brought about sweeping changes in the landscape of nonprofit governance, as well as in applicable legal and regulatory requirements in New York. **Every nonprofit is affected, and should have taken steps to comply. If your organization has not yet taken the necessary steps, these actions should be undertaken now with urgency.**

If you have questions about this Not-For-Profit Legal Alert or about your organization's governance practices and compliance with the Not-for-Profit Corporation Law and the Revitalization Act, please contact David Goldstein at the phone number or email address below. Also contact us to request to receive future mailings.

About the Author

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